

CIGARETTE TAX
RCW 82.24

Tax Base The sale, use, consumption, handling, possession, or distribution of cigarettes; the tax applies to the first such taxable event which occurs within the state.

Tax Rate The combined state tax rate currently totals \$2.025 per package of 20 cigarettes. (The federal government also levies a tax of 39 cents per pack upon cigarette manufacturers.) The \$2.025 state rate is comprised of the following:

- 23 cents. Receipts from this portion of the tax are deposited in the state general fund (RCW 82.24.020(1)).
- 8 cents. Proceeds are deposited in the water quality account and are used for various water-related programs (RCW 82.24.027). On July 1, 2021, the receipts are scheduled to be transferred into the general fund.
- 10.5 cents. Revenues go to the violence reduction and drug enforcement account to fund drug/alcohol programs (RCW 82.24.020(2)).
- 41 cents. Collections are deposited in the health services account (RCWs 82.24.020(3) and 43.72.900) and used to finance state health care programs.
- 60 cents. Receipts are deposited in the health services account. However, Initiative 773 also requires certain other distributions of these revenues, as described below (RCW 82.24.028 and 43.72.900(3)).
- 60 cents. Adopted in 2005 and effective on July 1, 2005, these proceeds go to the education legacy trust account and to "hold harmless" revenues going to other funds (RCW 82.24.026).

NOTE: The state also receives funds from a cigarette tax levied by the Puyallup Tribe. Legislation adopted in 2005 provides for an agreement between the state and this tribe relating to a tribal cigarette tax. Codified as RCW 43.05.465, the tribal tax is currently imposed at a rate of \$17.75 per carton and is in lieu of the state cigarette tax and state/local retail sales taxes. The agreement provides that 30 percent of the tribal receipts will go to the state general fund. The tribe first levied the tax in May 2005.

Levied by State

Administration Department of Revenue. The tax is paid via the purchase of stamps which are affixed to each package of cigarettes by stamping wholesalers. Special

licenses are required for sellers of cigarettes; fees for these licenses are paid to the Department of Licensing through the Master Business License application. Wholesalers subject to the cigarette tax are allowed compensation for their costs of affixing the stamps in an amount of \$6 per 1,000 stamps. Although the Department of Revenue administers collection of the tax, enforcement activities are performed by the Liquor Control Board.

Recent Collections (\$000)

<u>Fiscal Year</u>	<u>Collections</u>	<u>% Change</u>	<u>% of All State Taxes</u>
2006	\$435,813	34.7%	2.8%
2005	323,580	(3.7)	2.3
2004	336,156	2.0	2.6
2003	329,627	9.0	2.7
2002	302,337	23.6	2.6
2001	244,550	(2.2)	2.1
2000	250,109	(1.9)	2.1
1999	255,050	(1.5)	2.2
1998	258,870	1.9	2.3
1997	254,060	(0.8)	2.4

In addition, the state receives a portion of the tribal cigarette tax levied by the Puyallup tribe pursuant to RCW 43.06.465(3). This produced \$6.3 million for the state general fund in Fiscal Year 2006.

A breakdown of Fiscal Year 2006 cigarette tax collections (\$ in thousands) by account follows. The tax rates indicated and the dollar amounts include distributions to other accounts as a result of the education legacy tax but do not include reimbursement of other accounts per Initiative 773 (RCW 43.72.900(3), as discussed below.

General Fund (24.68 cents)	\$ 52,663
Water Quality (9.02 cents)	19,246
Drug Enforcement (11.88 cents)	25,420
Health Services (\$1.1402)	243,236
Education Legacy (42.9 cents)	95,248
Total FY 2006 Cigarette Tax	\$435,813

Distribution of Receipts

Receipts of the cigarette tax are distributed to the various accounts as outlined above.

Initiative 773, approved by the voters in 2001, contains a reimbursement mechanism for several of the existing accounts. It requires that 10 percent of the funds derived from the 60 cent tax for health services be distributed each year to the tobacco prevention and control account for use in programs that reduce smoking among Washington residents. The remaining receipts of the 60 cent tax, after the reimbursements discussed below, go to the health services account for supplementing enrollment in the state's basic health plan.

The purpose of reimbursement of the violence reduction/drug enforcement account, the water quality account, and the health services account is to acknowledge that the additional 60 cent tax rate for health services could adversely impact the collections for the other funds, if taxable consumption of cigarettes declines as a result of the increase in overall tax rate. Thus, RCW 43.72.900(3) specifies that the following dollar amounts shall be transferred from the receipts of the 60 cent tax to these accounts each biennium as follows:

Violence Reduction/Drug Enforcement Account: \$6,932,000
Health Services Account (for the initial 41 cent tax): \$28,622,000
Water Quality Account: \$7,885,000

These dollar transfers are not reflected in the tax receipt amounts shown above.

Similarly, the most recent 60 cent increase in 2005 for higher education requires reimbursement to other cigarette funds. RCW 82.24.026 stipulates that before distributing the remainder of the proceeds to the education legacy account:

21.7 percent goes to the health services account
2.8 percent goes to the general fund
2.3 percent goes to the violence reduction/drug enforcement account
1.7 percent goes to the water quality account.

Since these distributions are in terms of a percentage of the receipts (not a fixed dollar figure per biennium), they are included in the tax receipts amounts shown above.

Exemptions, Deductions and Credits

- Sales by wholesalers to persons in other states or countries.
- Sales to the federal government.
- Sales to Indians (via allocation program).

History

The cigarette tax was initially imposed as part of the Revenue Act of 1935 at a rate of 1 cent per package. The rate has been increased 18 times over the past 70 years. These and other major changes are summarized as follows:

1935 - Cigarette tax imposed at 1 cent per pack.

- 1939 - Rate increased from 1 to 2 cents per pack.
- 1949 - Rate increased from 2 to 4 cents per pack. Receipts from additional 2 cents earmarked for retirement of bonds issued to pay compensation to war veterans.
- 1955 - Additional tax of 0.5 cents per 10 cents of selling price (then roughly equivalent to 1 cent per pack). Receipts dedicated to public school building bond redemption fund until the bonds were retired, then to the general fund.
- 1959 - Rate increased from 5 to 6 cents per pack.
- 1961 - Rate increased from 6 to 7 cents per pack.
- 1965 - Rate increased from 7 to 11 cents per pack.
- 1971 - Rate increased from 11 to 16 cents per pack.
- 1972 - Bonds for veterans bonuses retired; compensation of \$250 extended to Vietnam veterans funded by the 2 cent rate (1949) until 1977 when the compensation was fully paid and the receipts began going to the general fund.
- 1975 - Previous exemption for possession of two cartons of unstamped cigarettes was repealed, thus strengthening cigarette tax enforcement.
- 1981 - Rate increased from 16 to 20 cents per pack.
- 1982 - Surtaxes increase the rate from 20 to 20.8 cents (5/1/82) and to 23 cents (8/1/82).
- 1983 - Surtaxes adopted in 1982 made permanent.
- 1986 - Rate increased from 23 to 31 cents per pack. Receipts from additional 8 cents earmarked for water quality programs. Revisions to the Unfair Cigarette Sales Act; regulation of cost of cigarettes, to expire in 1991.
- 1989 - Rate increased from 31 to 34 cents per pack. Receipts from additional 3 cents earmarked for drug education and enforcement programs. The additional 3 cent rate was scheduled to expire on July 1, 1995.
- 1993 - Rate increase from 34 to 54 cents per pack. Receipts from the additional 20 cent tax earmarked for health programs; rate increases for the following three years.
- 1994 - Rate increase from 54 to 56.5 cents per pack due to increase in the health services rate. Expiration of drug enforcement rate repealed and the 7.5 cent rate increase effective in 1995 is approved by both the Legislature and the voters.
- 1995 - Rate increased from 56.5 to 81.5 cents per pack due to 17.5 cent increase in the health services rate and 7.5 cent increase in the drug enforcement rate. Technical changes in the administration of the tax, including stamping of untaxed cigarettes for Indian consumption, tighter requirements for transporting cigarettes, and pre-collection of the tax in certain situations by Indian wholesalers.
- 1996 - Rate increased from 81.5 to 82.5 cents per pack due to 1 cent increase in the health services rate.
- 1997 - Enforcement shifted from Department of Revenue to the Liquor Control Board.
- 1999 - One-half of the 8 cent tax for water quality is diverted to a new salmon recovery account for two years and the remainder of the water quality tax goes to the violence reduction and drug enforcement account for two years.
- 2001 - Legislation was adopted allowing the state to enter into contracts with 16 Indian tribal authorities (currently 25 tribes) relating to the imposition of tribal cigarette taxes. The intention is for a tribe to enact a tax equivalent to the state cigarette tax, thereby providing the tribe with revenues for tribal services and also reduce the incentive for evasion of the state tax.
- 2001 - Cigarette stamping allowance is increased from \$4 to \$6 per 1,000 stamps.

- 2001 - Initiative 773, approved in November 2001, imposes an additional 60 cent tax.
- 2005 - Additional tax of 60 cents per pack levied to support higher education and other educational programs, effective July 1, 2005. The overall tax rate becomes \$2.025 per pack. Four new tribal contracts authorized, as well as a unique tribal tax for the Puyallup tribe by which the state receives 30 percent of the proceeds.

Discussion/Major Issues

Members of Indian tribes are not subject to tax on cigarettes sold on their reservation. The Department provides untaxed (but stamped) cigarettes to recognized tribes in an amount sufficient for the personal use of each tribal member, based on average per capita consumption rates. Non-tribal members have evaded the cigarette tax by purchasing cigarettes from Indian stores. This tax evasion is being addressed through state/tribal agreements by which tribal governments impose their own cigarette taxes at rates equivalent to the state tax rate. Presently, state law provides the authority for such contracts with 25 tribes located in the state.

The \$2.025 cigarette tax rate now levied in Washington is among the highest in the nation. Only two states - Rhode Island at \$2.46 and New Jersey at \$2.40 - currently have higher tax rates. Maine and Michigan, both with rates of \$2.00, are close behind Washington's rate. At the other end of the cigarette tax spectrum, 13 states, principally tobacco-producing southern states, have rates of 50 cents or less. The lowest rate is South Carolina's tax of \$0.07 per pack. There is concern that Washington's high tax rate will continue to exacerbate the cigarette tax evasion problem, because most neighboring states have significantly lower tax rates (Oregon, \$1.18; Idaho, 57 cents; California, 87 cents; and Nevada, 80 cents).

The Department estimates that evasion of cigarette tax amounts to roughly \$170 million per year (Fiscal Year 2005) in lost tax revenues, including state/local sales taxes. Evasion is attributable to purchases at non-compact Indian tribal smoke shops by non-Indians, to purchases made in other states, or to purchases via the Internet or mail order. In addition to the loss of revenue due to tax evasion, the long-term trend in cigarette consumption has been declining in Washington and nationwide. According to data released by the state Department of Health in 2006, Washington now has the fifth lowest rate of smoking in the nation at 17.8 percent of the adult population.

In the past, the cigarette tax has been used to fund bonuses paid to veterans and for retirement of school building bonds. Currently, the receipts are devoted to water quality improvements, drug programs, and health care, in addition to state general fund expenditures. There has been concern by some over the diversity of such programs funded by cigarette tax revenues and the lack of correlation between consumption of tobacco and the problems which these programs address.